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Virginia Law Register

VOL. XX.]

JANUARY, 1915.

[No. 9.

POWER OF CORPORATION TO PURCHASE ITS OWN STOCK.

ENGLISH RULE.

In England the rule is well settled both at common law and under the statutes, that a corporation has no power to purchase its own capital stock either directly or indirectly, unless it is given authority so to do either by and under its charter or its articles of association. In the absence of authority expressly given to traffic in its own stock, the purchase thereof by the corporation is ultra vires and invalid as an attempt to reduce the capital of the company and does not relieve the selling shareholder from liability for his contributory share in the settlement of the debts of the company on a winding up of its affairs. *Hope v. International, etc., Soc.*, L. R. 4 Ch. Div. 327; note to *Bank v. Burch*, 33 Am. St. Rep. 331.

This principle proceeds upon a want of power, rather than any express prohibition in its charter. *Morgan v. Lewis*, 46 O. St. 1, 17 N. E. 558. It is based, not only upon the ground that a corporation can not increase or diminish the amount of its capital stock as fixed by the legislature and on the ground that such transaction is a fraud upon the stockholders and creditors but also on the ground that it is foreign to the purposes for which the corporation was created, and therefore a violation of its charter, and a diversion of its funds to an unauthorized purpose. *Fitzpatrick v. McGregor*, 133 Ga. 332, 339, 65 S. E. 859. It is inconsistent with the essential nature of a corporation that it should become a member of itself. *In re Coal Co.*, 17 Ct. D. 83. The object of this rule manifestly is to preserve the rights of the corporate creditors by preventing a diminution of the stock, and also to confine the corporation within the express powers given it, and the implied powers necessary to the transaction of its business. *Nicols' Case*, 3 De Gex & J. 387; note to *Bank v. Burch*, 33 Am. St. Rep. 331.

The articles of association of some corporations empower them to accept a surrender or forfeiture of his shares from a stockholder. In such case the power will be strictly construed, and if any doubt exists as to the facts or any irregularity appears in the transaction it will be held to be a sale instead of a surrender and cancellation, and the stockholder will be deemed liable for his contributory share on the winding up of the affairs of the corporation. *Hall's Case*, L. R. 5 Ch. 707. But it has been upheld although the transfer of the shares sold by the stockholder to the corporation is not made in strict accordance with the provisions of the articles of association. *Nicols' Case*, 3 De Gex & J. 387; note to *Bank v. Burch*, 33 Am. St. Rep. 331.

In some states, the rule is, as in England, that a corporation, in the absence of statutory authority, can not purchase its own shares of stock, as it constitutes a fraud upon creditors. *Hall v. Terminal & Improv. Co.*, 143 Ala. 464; *Maryland Trust Co. v. Bank*, 102 Md. 608; *St. Louis Rawhide Co. v. Hill*, 72 Mo. App. 142; *Abeles v. Cochran*, 22 Kan. 405, 31 Am. Rep. 194; *Coppin v. Greenles, etc., Co.*, 38 Ohio St. 275, 43 Am. Rep. 425; *Cartwright v. Dickinson*, 88 Tenn. 476, 17 Am. St. Rep. 910; *Crandall v. Lincoln*, 52 Conn. 73.

As is the case with the decisions of the English courts, the decisions of these states are based on the want of power of a corporation to purchase its stock. The theory adhered to is an absence of power. This pervades all the opinions, although other reasons are assigned. Such transaction is considered an unlawful diminution of the capital stock, a fraud upon the creditors who deal with the corporation on the faith that the capital is paid up, and a fraud upon and violation of the contract with the other stockholders. But the main difference between these cases and those of the weight of American authority is, as stated, a want of an inherent corporate power.

A corporation by the purchase of its own shares diminishes its capital to the extent of the shares so purchased, save in the instance where the stock is bought to secure the payment of an antecedent debt. *First Nat. Bk. v. Nat. Exchange Bk.*, 39 Md. 600. A corporation has no power to reduce the amount of its authorized capital stock by purchase of its own shares for cancellation. *Cartwright v. Dickinson*, 88 Tenn. 470. In Mary-

land Trust Co. *v.* National Mechanics' Bank (Md.), 63 Atl. 70, 77, it is said: "We agree with Mr. Morawetz that, if the decisions which maintain the right of a corporation to purchase its own shares are carried to their logical results, it is apparent that a corporation may at any time, by an easy process, be made to shrink away and finally vanish into nothing. It would only be necessary to 'purchase' shares from its stockholders; and in the end, after the last stockholder had 'sold' his own shares to the company and withdrawn with the proceeds, nothing material would remain to attest the former existence of the corporation except an empty treasury and canceled stock certificates. Mor. on Corp., § 113."

Creditors have a right to assume that stock once issued, and not called back in the manner provided by law, remains outstanding in the hands of the stockholders liable to respond to creditors to the extent of the individual liability prescribed. Surely, if the law forbids the organization of a corporation without stock, because the required security is not furnished, it can not be that, having brought the corporation into existence, it invests it with power to assume at pleasure the identical character or relation to the public that was an insurmountable objection to the giving of corporate existence in the first place. Maryland Trust Co. *v.* National Mechanics' Bank (Md.), 63 Atl. 70, 75. The purchase by a corporation of shares of its own capital stock is a fraud upon its creditors. Such shares neither import nor represent any right or claim in or to, or to subject to their payment, the assets of the corporation as against the rights of creditors. Shares purchased by the corporation have no value as assets for the payment of corporate debts. Obviously, therefore, the transaction involves, on the one hand, the diversion of corporate assets to persons—shareholders—who have no debt against the company, nor the shadow of claim to or against its assets so far as creditors are concerned, and, on the other, the acquisition by the company, in the stead of assets thus diverted, of a mere right to reissue certain shares, or shares to a certain amount in its capital, which right is of no value as assets for creditors. Such a diversion of corporate property is, in respect of creditors, essentially a gift to the shareholders whose shares are purchased by the company, a purely voluntary

transfer of corporate assets in fraud of corporate creditors, fraudulent and void as to creditors, and this regardless of the intention actuating the company and the selling shareholders. *Hall & Fareley v. Alabama Terminal & Improvement Co.*, 143 Ala. 464, 39 So. 285, 291.

These cases recognize certain exceptions to the rule that a corporation can not purchase its own stock. The exceptions are to prevent a loss to the corporation, as where the stock is taken in payment of an antecedent debt, and, it seems, where the transaction has become executed. Conceding the principle that a corporation can not buy its own stock, and that this principle proceeds upon a want of power, rather than any express prohibition in its charter, the right of a corporation to take its own stock in satisfaction of a debt due to it has long been recognized, the exception being based upon the necessity of avoiding loss. And it is because of such necessity, not because it is for the satisfaction of a debt, that the exception is recognized. If the same or like necessity of avoiding loss should arise in any of the transactions of the company, it could not, with any show of reason, be contended that its application should be limited by any rule to the case of taking stock for an otherwise hopeless debt. *Morgan v. Lewis*, 46 O. St. 1, 17 N. E. 558. An executory agreement between a corporation and one of the stockholders, for the purchase of the stock of such corporation, by the former from the latter, can not be enforced, but that this presents a very different case from one of an executed contract is asserted in some cases. *Morgan v. Lewis*, 46 Ohio St. 1; *Dacovich v. Canizas*, 152 Ala. 287. Some of the decisions recognize an exception to the rule that a corporation can not purchase its own stock where the contract has become executed. It is, however, difficult to harmonize this exception with those cases which hold such transaction against public policy and void.

AMERICAN RULE.

The current of American authority is, however, opposed to the doctrine announced by the English courts, as in this country it is very generally maintained that, in the absence of statutory prohibition, a solvent corporation or its officers may invest its funds in the purchase of its own stock, or may take such stock

in payment of debts due it by the stockholder, or may take it in exchange for other property owned by the corporation. *Fitzpatrick v. McGregor*, 133 Ga. 332, 65 S. E. 859, 862. This rule is followed in Virginia in *United States Mineral Co. v. Camden & Driscoll*, 106 Va. 663. It is based upon an inherent power of a corporation to purchase its stock and is therefore in direct conflict with the English rule. Any attempt to reconcile the two is futile. The English rule is that a corporation does not possess such power, to which there are certain exceptions, while the American is that such power is possessed, and to this there are certain exceptions.

These cases refuse to apply the doctrine that the capital stock of a corporation constitutes a trust fund for the payment of its debts. "Upon principle, we think it would be pushing the doctrine of trusts as applied to the capital stock of an incorporated company too far to hold that it takes away the power of the corporation to purchase its stock under any and all circumstances, for this would be to deprive it of the right to make an investment which, in a given case, might be highly advantageous both to the creditor and the corporation, and would moreover ignore all distinctions between a corporation which is insolvent or in process of dissolution, and one which is engaged in a prosperous and active business, with abundant means to meet all its obligations. If, in contemplation of winding up, or when insolvent, a corporation should attempt to divide its effects among its stockholders, either directly or indirectly, by accepting a surrender of their stock in exchange for the corporate property, the transaction would not be upheld as against the equitable rights of creditors; and this, it is apprehended, is the limited application of the doctrine which the American courts and text-writers have intended when speaking of the trust character of capital stock, rather than that general and universal application which would deprive a corporation of all power and discretion in respect to the disposition of its capital stock." *Fraser v. Ritchie*, 8 Ill. App. 554, 560.

The objection, which grows out of the trust fund doctrine, has been raised, that the capital stock of the corporation is decreased by the purchase of its stock, and it has been held that the effect of a corporation's buying its own stock from one of

its stockholders is to retire, temporarily at least, that much of its capital stock, and therefore to diminish pro tanto the amount of its capital stock. *Dalton Grocery Co. v. Blanton*, 8 Ga. App. 809, 811, 70 S. E. 183. But it has also been held that the mere purchase of its stock does not tend to decrease the capital stock of a corporation in violation of a statutory prohibition, unless the directors absolutely merge or extinguish the stock after its repurchase. The company can own and deal with it just the same as it had done before the sale. It can be sold and issued again. The company is in no different position as to this stock than it would have been had the transaction in regard to it never occurred. When it is transferred to the company, it becomes part of its property. It is there for the creditors and stockholders. The capital stock is not decreased. A portion of the capital of the company may be unavailable until the stock is again sold and issued, but nothing is destroyed. Whether the stock is merged or extinguished or held as an asset for sale is much a matter of intention on the part of the corporation. *Porter v. Plymouth Gold Mining Co.*, 29 Mont. 347, 74 Pac. 938, 101 Am. St. Rep. 569, 574. A corporation can not buy its own stock from its stockholders to such an extent as will diminish the outstanding capital stock below the minimum stated in its charter. *Dalton Grocery Co. v. Blanton*, 8 Ga. App. 809, 70 S. E. 183.

The creditors of the corporations can question the purchase or exchange when the circumstances are such as to show that the transaction was fraudulent in fact, or that the corporation was insolvent, or in process or contemplation of dissolution at the time the purchase or exchange was made, and also that the transaction diminished their security for the debts due them. *Fitzpatrick v. McGregor*, 133 Ga. 332, 65 S. E. 859, 862. In case an insolvent corporation buys its own stock, or the effects of such a purchase is to render it insolvent, the transaction is void as to existing creditors. *Land, etc., Co. v. Pepper*, 95 Va. 92. A purchase, known by the parties to the transaction, or which ought to be known by them, to render the corporation insolvent, is not a purchase in good faith as to existing creditors and not such as to future creditors if the parties to the transaction contemplate that the corporation will continue to do business and incur indebtedness, as before, on the faith of its previously supposed

solvency continuing. *Atlanta & Walworth Butter & Cheese Ass'n v. Smith* (Wis.), 123 N. W. 106, 108.

It is difficult, if not impossible, to define the source of this corporate power, and probably there is no case among those asserting its existence which attempts to do so. The powers of a corporation are those expressly conferred upon it by its charter and the general statutory provisions of the state of its incorporation and such implied powers as are necessary for the furtherance of the purposes of its incorporation. When not so expressed, it is certainly in exceptional cases only, that the purchase of a corporation's own stock is necessary to the furtherance of the purposes of its incorporation. This inability to define clearly such corporate power and to maintain logically a reason for its existence has not, however, deterred the majority of the courts of the United States from attributing such power to a corporation, and their ruling has not been attended with all the calamities pointed out by those who are inclined to prefer the English rule, such as the corporation absorbing itself, reducing its capital stock required to be subscribed to by its charter and the destroying of the security of the creditors of the corporation. On the other hand, the ruling has been applied with regard to the rights of all persons interested, creditors and stockholders. The only persons, aside from the state itself, who can possibly be injured by such transaction are the other stockholders and corporate creditors. The other stockholders who have consented to the sale can by no possibility have a right to complain. They are estopped, although the English cases apply the doctrine that there can be no estoppel against such *ultra vires act*, and where stockholders do not consent, the transaction being fraudulent as to them is within an exception to the rule. The right of the corporate creditors is that of security for and payment of their claims. They have no concern with the corporate funds over and above that amount, of the surplus of a solvent corporation. This is the limited operation given the rule. The stockholder is not a partner and his relation to the corporate creditors is not that of a partner to partnership creditors. The creditors have no claim against the stockholder as an individual, other than the stockholder's liability arising from his contract of subscription, and such liability as is imposed upon the stockholder by statute. When the stockholder's subscription

contract has been complied with, neither the corporation itself nor its creditors can further call upon the stockholder, and, if his subscription contract has not been complied with, the purchase of his stock and the relieving him of his liability for his unpaid subscription, is a fraudulent transaction and comes within one of the exceptions to the rule. The transaction which relieves the stockholder of his statutory liability also comes within another of the exceptions to the rule.

This power of a corporation is in its nature more a permissive than an inherent power, and the courts so considering it are not inclined to permit a corporation's freely exercising it and uphold such transactions only as are in no way injurious to either stockholders or creditors. As said in *Fraser v. Ritchie*, 8 Ill. App. 554, 559, each case must depend upon and be determined by its own facts and circumstances, and difficulty sometimes grows out of the proper application of the rule of law to the facts of the particular case.

A corporation may purchase its own stock under a statute providing that no corporation shall employ its assets for any other purpose than to accomplish the objects of its creation (*Howe Grain, etc., Co. v. Jones*, 21 Tex. Civ. App. 198, 51 S. W. 24), and under a statute making its shares personal property and giving power to purchase such personal property as the purposes of the corporation shall require (*Berger v. United States Steel Corp.*, 63 N. J. Eq. 809, 53 Atl. 68), a statutory provision that a corporation may accept its stock in payment of debts, affords no implication that it may not purchase such stock under other circumstances. *Moses v. Soule*, 118 N. Y. Supp. 410. A statute providing that the shares of stock belonging to the corporation shall not be voted directly or indirectly does not confer authority on the corporation to purchase its own stock; nor is such power conferred by a statutory provision authorizing the corporation to acquire and convey property. *Coppen v. Greenlees*, 38 O. St. 275. The right to purchase its own stock is inconsistent with a statutory provision for the securing of the individual liability of stockholders. *Coppen v. Greenlees*, 38 O. St. 275.

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